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September 6, 2019

VIA ELECTRONIC FILING

The Honorable Jocelyn G. Boyd
Chief Clerk/Administrator
The Public Service Commission of South Carolina
101 Executive Center Drive, Suite 100
Columbia, South Carolina 29210

**Re: Procedure to Address Treatment of Deferrals (See Page Number 5 of Order
No. 2019-341)
Docket No. 2019-233-A**

Dear Mrs. Boyd:

Enclosed for filing in the above-referenced docket, please find Comments of Duke Energy Carolinas, LLC and Duke Energy Progress, LLC.

Please do not hesitate to contact me if you have any questions or require any further information.

Sincerely,

A handwritten signature in blue ink that reads "Heather Shirley Smith". The signature is written in a cursive, flowing style.

Heather Shirley Smith

Enclosure

C: Parties of Record (via email)

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2019-233-A

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| IN RE: |) | |
| |) | |
| Procedure to Address Treatment of |) | COMMENTS OF |
| Deferrals (See Page Number 5 of |) | DUKE ENERGY CAROLINAS, LLC |
| Order No. 2019-341) |) | AND DUKE ENERGY PROGRESS, LLC |
| |) | |

Duke Energy Carolinas, LLC (“DEC”) and Duke Energy Progress, LLC (“DEP”) (collectively “Duke Energy” or “Companies”) have filed notices of appearance in this docket, opened by the Public Service Commission of South Carolina (“Commission”) to address issues relating to deferral accounting practices. This proceeding was originally proposed by the Office of Regulatory Staff (“ORS”) in Docket 2018-206-E (and referenced in Order No. 2018-751) in an effort to create more clarity and predictability relating to the consideration and approval of requests for deferral accounting treatment, and was discussed in the Companies’ recent base rate proceedings in Docket Nos. 2018-318-E and 2018-319-E. In response to the ORS request, the Commission initiated this proceeding and issued Order No. 2019-477 requesting comments by September 6, 2019.

Duke Energy agrees with the ORS that clarity and predictability regarding deferral accounting treatment is needed, and submits that the Commission should consider the views of stakeholders and issue non-binding guidelines that help provide clarity and predictability to what sorts of information the Commission will consider when it receives requests for deferrals. These

comments are submitted to provide the views of Duke Energy regarding the content of those guidelines.

I. Background – The Commission’s History of Allowing Deferral Accounting.

Preliminary, it is important to understand what deferral accounting is, why it is used and what the Commission’s role is in considering requests for orders in this regard. In seeking deferrals, a utility requests an accounting order from the Commission in which the Commission would approve the creation and use of a regulatory asset to be considered for recovery in a future rate proceeding.

This Commission has a long history of approving and allowing regulated utilities to engage in deferral accounting where such an approach serves the public interest. In 1957, the Commission allowed United Telephone Company of the Carolinas to create deferral accounts to allow the company to take advantage of IRS approved accelerated depreciation rules on the ground that accelerated depreciation would assist the utility in expanding and modernizing its facilities. See Order No. 10,284 in Docket 10,132. In 1973, the Commission approved similar deferral accounting treatment for South Carolina Electric & Gas to allow it to take advantage of accelerated depreciation to assist in financing construction of needed facilities. See Order No. 17,300 in Docket No. 17,224. In 1996, in Order No. 96-337 issued by the Commission in Docket Nos. 85-78-E, 86-188-E and 91-216-E, the Commission approved the use by Duke Power Company of deferral accounting to “alleviate rate shock” and provide “rate stability” and approved an interim rate decrement rider to allow immediate rate relief to customers.

Further, deferral accounting has been approved regularly by the Commission to address earnings issues associated with investments in new generating facilities. In Order No. 2012-208 in Docket No. 2012-57-E, the Commission approved deferrals related to the addition of the DEC

Buck and Bridgewater generating facilities. In Order No. 2013-351 in Docket No. 2013-155-E the Commission approved deferral accounting of costs related to the addition of DEC's Wayne County combined cycle facility, finding that "granting the Petition will avoid the Company having to undergo a sizeable decline in its earnings, and will aid in helping the Company maintain access to capital on reasonable terms." Order No. 2013-351, p. 4.

In Order No. 2017-52 issued in Docket No. 2016-408-E the Commission addressed accounting issues related to recovery of storm related expenses resulting from Hurricane Matthew. In its petition requesting deferral accounting treatment of operating and capital costs caused by the weather effects of the hurricane, DEP argued that an order allowing the deferral of storm costs was appropriate because of the extraordinary nature of the storm and the potential earnings degradation if deferral was not allowed. The Commission granted DEP's petition and approved the deferral of incremental operations and maintenance costs and depreciation and the deferral of carrying costs for the identified storm-related costs. See Order No. 2017-52, p. 5.

The history of this Commission's approval of deferral accounting, which is even broader than the few orders cited above, includes numerous examples of where the Commission has determined that deferral will serve the public interest. Deferral accounting has been approved to assist regulated companies in financing system improvements and expansions. It has been approved to avoid rate shock and to smooth out potential rate increases caused by the addition of new generation facilities or extraordinary expenses associated with hurricanes and ice storms. Deferral accounting treatment allows regulated utilities to delay filing rate cases, a result that the Commission has traditionally found to be in the public interest.

In its most recent rate case (Docket No. 2018-318-E) DEP presented testimony from Laura Bateman on the subject of the benefits to customers of the use of deferral accounting. In part, her testimony stated that:

Customers have benefitted through delays of and mitigation of rate increases that directly resulted from the deferrals in this case, and I think some background on the deferrals would be helpful in understanding that. If you look at the deferrals in this case, Fukushima/Cybersecurity and Harris COLA were part of a 2013 deferral petition that specifically stated that the deferrals would enable to Company to delay a rate case filing. At the time, the ORS found value to customers in that benefit and the commission approved the petition. In the last rate case, the Company was able to mitigate the increase to customers in that case by delaying recovery continuing 4 of the deferrals (Fukushima/CyberSecurity, Harris COLA, 2014 Storms, and coal ash. The ORS was a party to that settlement. Finally, in last rate case settlement, we agreed to a two year stay out, and had the expectation that we would be filing again for new rates effective 1/1/2019, to start collecting the costs we had deferred. Last spring, the company determined it could delay its rate case filing if it was able to secure certain deferrals and filed petitions for deferrals for costs related to Customer Connect, AMI deployment, increases in depreciation rates and the grid improvement plan. The commission approved those petitions. Even just a 5 month delay in the increase benefits customers by anywhere from \$10-\$20M, depending on the increase ultimately approved by this Commission.¹

In its orders granting approval of deferrals the Commission has consistently been clear that its approval of the accounting treatment does not foreclose any party from contesting the reasonableness or prudence of the underlying costs being deferred. The orders allowing deferrals have not approved any rate increases and have reserved questions relating to the prudence of the costs. Typical of the Commission's approach on this point is this statement from Order No. 2013-351: "[w]e note that granting the relief Duke seeks in its Petition will not preclude the Commission from addressing the reasonableness of the costs deferred in the regulatory asset account in the Company's next general rate proceeding. No change in rates will occur as a consequence of the approval of this Order." Order No. 2013-351, p. 4.

¹ Transcript, Volume 3, p. 331 ln 11 – p. 333 ln 1.

II. Criteria for the Commission's consideration in approving deferrals.

Duke Energy submits the following list of considerations that should be included in the deferral guidelines as proposed by the ORS. These considerations are not intended to be requirements, they may not each be applicable to every deferral request, and in some cases, they may be in tension with each other. However, the Companies submit that all of these considerations are relevant to requests for deferral accounting treatment.

1. Whether the expense being incurred by the utility is significant to the utility. Deferral accounting treatment should be reserved for substantial expenditures by the regulated utility. Because of the different size of the various entities regulated by the Commission, it is not clear to Duke Energy whether it is possible to specifically define what is substantial for purposes of the guidelines; moreover what is significant can be subjective and should be considered, the Companies believe, based on the facts and circumstances described by the utility making the request.

2. Whether the expense is out of the ordinary. Duke Energy submits that deferral accounting should usually not be allowed for the ordinary costs of doing business that are already captured within the ratemaking process. The history of the Commission's treatment of deferrals shows that it has been applied to extraordinary costs or costs caused by extraordinary events, with the understanding that "extraordinary costs" includes costs associated with the addition of significant new facilities.

3. Whether the expense is necessary, could not have been reasonably anticipated by the utility, or is beyond the utility's control. Costs associated with extraordinary storm events are

an example of expenses that may be considered for deferral accounting treatment, as could be material fluctuations in prices in excess of what is included in rates for a given category.

4. Whether the expense is of a nature that complete cost recovery cannot be captured through traditional ratemaking. For example, expense associated with bringing a new generating resource or infrastructure coming on line where recovery of the expense will lag until a rate case can be filed and decided would be a good example of this consideration.

5. Whether the expense is currently included in rates. Deferral accounting should not be allowed where the expense is currently included in rates unless there is an unforeseen or unanticipated event that causes a significant increase in the expense.

6. Whether the denial of the accounting request could adversely affect the utility's earnings as compared to the most recently allowed return set by the Commission. In assessing prior accounting order requests, the Commission has appropriately taken into account the potential impact of expenses on earnings in determining whether to allow deferrals. Duke Energy submits that the public interest will continue to be served by that approach.

7. Whether the deferral results in procedural efficiency. Deferral accounting has proved to be a useful tool for reducing the number of rate cases filed by utilities.

8. Whether the deferral will be included in a rate case within a reasonable time. Deferrals in South Carolina have often included a return during the deferral period. While deferrals can be important in helping spread out rate cases, there is logically a concern with deferrals being in place for too long where carrying costs can accumulate. This is a balancing of cost and benefit that the Commission should address on the facts of each request and case.

9. Whether the deferral helps advance any technological improvement, modernization or compliance with applicable law or regulation. The Commission has a long history of

allowing deferrals where they will assist utilities in modernizing and expanding facilities to provide better service or to comply with changes in law. This is an appropriate use of deferral accounting and should continue to be a consideration for the Commission.

10. Whether the cost being deferred will ultimately create customer savings or operational benefits from what would otherwise occur absent the expenditure. Whether a project creates customer savings in the fuel clause or other riders should be a consideration, particularly if it is a discretionary investment on the part of the utility. It would not be in the customers' best interest to leave in place a financial disincentive (base rate regulatory lag) on an optional project that could save customers money. For example, if a discretionary capital investment can glean operational savings or fuel savings for the benefit of customers, such investment may well be in the public interest and appropriate for deferral accounting. The Companies believe that the Commission should have the flexibility to grant deferrals for these types of projects when it is deemed to be in the customers' best interest.

11. Any other criteria deemed important by the Commission based upon the facts and circumstances for each individual request. Nothing in the guidelines should be binding upon the parties or the Commission, as this is not a rulemaking proceeding. Nor should the Commission foreclose the possibility that there could be a meritorious deferral request that falls outside of the suggested guidelines above.

III. Financing Costs.

The ORS request for a proceeding to consider guidelines for deferrals also was brought up during a dispute between ORS and Duke Energy in Dockets 2018-318-E and 2018-319-E concerning questions of whether DEC and DEP should be allowed to recover financing costs on deferred costs. The ORS position in the two cases was a new policy position, and in effect was that

a utility should not be allowed to recover financing costs of weighted average cost of capital on any cost that would be classified as an operating expense in the normal course of ratemaking. In addition, ORS proposed long amortization periods for some of the deferral accounts, during which there would be no recovery of costs necessary to finance the amount during the amortization period. This policy for deferral treatment cannot be found in accounting literature. In fact, the accounting standard that addresses deferrals (ASC 980-340-25-1) describes a deferral as the “capitalization” of costs that would otherwise be expensed. In other words, accounting guidance would say that all deferred costs are capital, regardless of how the cost would have been categorized absent the deferral.

The Companies took a different position than ORS in the two rate cases. Deferrals, by definition, recognize that the utility is incurring a cost that is not currently recovered in customer rates. The utility is incurring costs related to these deferrals. Those costs, whether designated as capital or operating expense for accounting purposes, require cash. That cash must be obtained from the utility’s debt and equity investors. And those investors require interest, or a return, on the cash they have invested in the utility. These financing costs (the return on the deferred costs) are a real cost that the utility incurs, and to disallow recovery of these costs during the deferral period or the amortization period would be to disallow prudently incurred costs. If the ORS again recommends the disallowance of any return during the amortization period on a portion of all the deferrals, the longer amortization periods exacerbate the disallowance. Again, the logic is contradictory. ORS doesn’t support a return because the costs were not originally classified as operating expense, but then takes the inconsistent position of recommending that the same costs be treated like capital costs by proposing that deferrals be recovered over the life of the assets.

Duke Energy has outlined the differences between its position in the rate cases and the position taken by the ORS in order to underscore that this is an issue for which guidance from the Commission is needed. The issue of whether and the extent to which financing costs will be allowed on costs allowed to be deferred during the deferral period prior to a rate case, and the amortization period after a rate case, is critical if deferrals are to continue to be used to serve the public interest as allowed and approved by the Commission in the past. Duke Energy believes that the approach advanced by the ORS in Dockets 2018-318-E and 2018-319-E will discourage the use of deferral accounting and will significantly limit the usefulness of deferrals in serving the purposes for which they have been approved in the past.

In addition, the ORS's proposal in Dockets 2018-318-E and 2018-319-E of disallowing returns on deferred balances based on the accounting classification of the original cost is novel, unprecedented, not supported by any accounting standards and in many ways logically inconsistent: First, the ORS proposal is novel and unprecedented. Duke Energy has reached out to peer utilities and has not found any other state utility commission that applies such a standard. In addition, the ORS has not provided any other state that applies such a standard. So, it appears that this proposal is not just new in South Carolina but is new and unprecedented from other regulatory jurisdictions as far as Duke Energy is aware.

Second, there is no accounting basis for applying such a distinction to deferred balances. In its testimony in the rate cases the ORS presented its accounting witness who cited several accounting authorities in his pre-filed testimony, but on the stand, he acknowledged that the ORS proposal was not developed based on any of the authorities that he had cited. Docket No. 2018-319-E, Transcript Vol. 7, lines 3-17. For example, in its testimony, ORS referenced that the National Association of Utility Commissioners ("NARUC") Rate Case and Audit Manual states

that regulatory assets and other deferrals should be examined to determine if the deferred costs are appropriate to be included in rate base. However, the manual says nothing about splitting the regulatory assets between deferred operating expenses and deferred capital costs. The same is true of the Deloitte Regulated Utilities manual and the FERC electric chart of accounts referenced by the ORS in those cases. No accounting guidelines for deferred costs make reference to splitting the regulatory assets between deferred operating expenses and deferred capital costs. None of the accounting authorities referenced support the ORS's proposal because there is no accounting basis for the proposal. Again, the accounting standard that addresses deferrals (ASC 980-340-25-1) describes a deferral as the "capitalization" of costs that would otherwise be expensed. Therefore, accounting guidance would say that all deferred costs are capital, regardless of how the cost would have been categorized absent the deferral.

Utilities have a real cost of debt and a real cost of equity for funds that they need to obtain. While parties may dispute the appropriate level of these costs, no party contends that these costs aren't real. In the case of a deferral, the funds need to be raised from outside sources because they are not being collected from customers in current rates, and instead will be recovered in the future, and the cost of debt and equity does not change based on the accounting classification of the costs absent a deferral.

The ORS proposal is logically inconsistent. For example, the ORS proposes excluding deferred balances from rate base because they resulted from operating expenses. However, they ignore the numerous balances that reduce utility rate base for the benefit of customers that also result from operating expenses. For example, excess deferred income taxes, operating reserves, storm reserves, and accumulated depreciation reserve are balances that result from operating expenses that currently reduce rate base and save customers hundreds of millions of dollars.

As outlined earlier, deferrals have provided significant benefit to South Carolina customers in the past. The Commission can consider returns on a case by case basis – and may choose in some circumstance based on the specific circumstance to grant a deferral without a return, particularly if the underlying deferred cost is found to be imprudently incurred. However, in other circumstances, when it is in the best interest of customers, any guidelines issued by the Commission should not summarily eliminate financing costs from deferrals during the deferral period or amortization period for the reasons stated above.

DEC and DEP appreciate the opportunity to provide these comments. The Companies also believe that it would be helpful to the Commission if they and other parties are allowed an opportunity to respond to comments filed in this docket.

Dated this 6th day of September, 2019.

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Attorneys for Duke Energy Carolinas, LLC
& Duke Energy Progress, LLC

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA

DOCKET NO. 2019-233-A

IN RE:)
)
Procedure to Address Treatment of)
Deferrals (See Page Number 5 of)
Order No. 2019-341)
_____)

This is to certify that I, Toni C Hawkins, a paralegal with the law firm of Robinson, Gray Stepp & Laffitte, LLC, have this day caused to be served upon the person(s) name below the **Comments of Duke Energy Progress, LLC and Duke Energy Carolinas, LLC** in the foregoing matter via electronic mail as follows:

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Dated this 6th day of September, 2019.

